91-722

Supreme Court, U.S.
FILED
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NO.

IN THE

Supreme Court of The United States

OCTOBER TERM, 1991

NL INDUSTRIES, INC.

Petitioner,

v.

GHR ENERGY CORPORATION,
SOUTHERN STATES EXPLORATION, INC.
AND S.A. HOLDITCH & ASSOCIATES, INC.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. May punitive damages for intentional postpetition torts committed by a debtor in possession constitute allowable administrative expenses under 11 U.S.C. § 503(b)?

2. Did the dismissal of a claim solely on the basis that it was not allowable as a first priority administrative expense, and without any opportunity for the claimant to avail itself of the Bankruptcy Code's procedures for alternate treatment of its claim, deprive the claimant of property without due process of law in violation of the Fifth Amendment of the United States Constitution?

3. Under *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145 (1968), may the decision of a contractually designated arbiter be binding where the arbiter has a prior undisclosed business relationship with one of the parties?

LIST OF PARTIES

The parties to the proceedings below were petitioners NL Industries, Inc. and respondents GHR Energy Corporation, Southern States Exploration, Inc. and S.A. Holditch & Associates, Inc.

RULE 29.1 LISTING

The parent corporation of petitioner NL Industries, Inc. is Valhi, Inc. NL Industries, Inc. has no subsidiaries other than its two wholly-owned subsidiaries, Kronos, Inc. and Rheox, Inc. Tremont Corporation also has a financial interest in the outcome of this litigation.

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Petitioner NL Industries, Inc. respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered on September 10, 1991.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 940 F.2d 957 and is reprinted in the appendix (A). The opinions of the United States District Court for the Southern District of Texas, Houston Division, have not been reported and have been reprinted in the appendices (B, D).

JURISDICTION

Jurisdiction of this Court to review the judgment of the Fifth Circuit is invoked under 28 U.S.C. § 1254(1).

By order of June 3, 1991, the Fifth Circuit affirmed in part and reversed in part the judgment of the district court, and

remanded for further proceedings. 932 F.2d 422. On June 17, 1991, NL timely filed a petition for rehearing and a suggestion for rehearing en banc. By unreported order of July 5, 1991, reprinted in the appendix (F), the Fifth Circuit denied the petition for rehearing and the suggestion for rehearing en banc. The Fifth Circuit then issued a "corrected opinion" on July 26, 1991. 934 F.2d 580. On September 10, 1991, the Fifth Circuit withdrew its "corrected" opinion and issued a third opinion. 940 F.2d 957. On September 16, 1991, this Court granted an extension of time to file this petition to November 2, 1991. This petition has been timely filed pursuant to Supreme Court Rule 13.2.

STATUTES INVOLVED

This case involves consideration of 28 U.S.C. § 959(b), which requires debtors in possession to operate in accordance with valid state law, and 11 U.S.C. § 503(b)(1)(A), which requires that the actual and necessary costs and expenses of preserving a debtor's estate shall be allowed as administrative expenses. This case also involves the due process clause of the Fifth Amendment to the United States Constitution and 28 U.S.C. §§ 157(d) and 158, which govern the requirements for a district court to regain original subject matter or appellate jurisdiction over bankruptcy matters referred to the bankruptcy court. Also relevant, but not directly in issue, are 11 U.S.C. § 507(a)(1), which accords first priority to allowed administrative expenses; 11 U.S.C. § 1129(a)(9)(A), which mandates that, in order to be confirmed, a plan of reorganization must provide for payment in full of allowable administrative expenses; and 11 U.S.C. § 1141(d)(1)(A), which governs the dischargeability of debts upon confirmation of a plan of reorganization. As required by Supreme Court Rule 14.1(f), the text of these statutes and rules is set forth in the appendix (J).

STATEMENT OF THE CASE

The Fifth Circuit held that punitive damages based on postpetition torts by a debtor in possession could not constitute an allowable administrative expense in a Chapter 11 reorganization proceeding. The Fifth Circuit's ruling conflicts both in reasoning and result with decisions by this Court and several other circuits and undermines the Bankruptcy Code's ability to effectuate successful reorganization.

In 1983, GHR Energy Corporation and Southern States Exploration, Inc. (collectively "GHR") filed voluntary petitions for reorganization under Chapter 11. In 1985, as part of GHR's reorganization and with express authorization of the bankruptcy court, GHR and NL entered into an agreement for the workover of 10 existing GHR gas wells to increase their productivity (the "Agreement"). R. 216, Ex. 1. In 1986, NL sued GHR in federal district court as permitted by 28 U.S.C. § 959(a), alleging contract and tort claims, including fraud, arising out of GHR's performance of the Agreement. R. 1114. NL claimed over $15 million in actual damages and sought punitive damages. NL later amended to add S.A. Holditch & Associates, Inc., as a defendant. R. 821. Holditch had been appointed to review the workover procedures under the Agreement.

In bankruptcy court, NL filed its request for payment of disputed administrative expenses in a document titled "Proof of Claim." NL's request for payment was filed expressly pursuant to 11 U.S.C. §§ 503 and 507, which govern claims for administrative expenses. R. 216, Ex. 16. NL's district court complaint demanding both actual and punitive damages was attached to and incorporated in NL's request for payment of administrative expenses. The bankruptcy court subsequently entered an order classifying NL's claims as disputed administrative expenses.

GHR's plan of reorganization provided for payment in full of allowable administrative expenses, including disputed administrative expenses such as NL's tort claims once they were liquidated, whether such expenses were allowed by the bankruptcy court before or after confirmation. R. 216, Ex. 20, p. 6-7, 53; 216, Ex. 19, p. 373 (App. G, I). Without these provisions, GHR's Plan would not have been confirmable. 11 U.S.C. § 1129(a)(9)(A).

To obtain confirmation, GHR repeatedly and unequivocally reaffirmed the effect of the Plan with regard to NL's claims in particular, stating that NL was "absolutely, totally 100% protected," R. 216 Ex. 28, p. 81, that GHR could "pay all allowed administrative expenses regardless of their size, as required by the Bankruptcy Code," R. 216, Ex. 24, p. 8, and that "[a]ll administrative expenses that are allowed will be paid in full, whether they are allowed before or after confirmation. *The Plan could not do any more to satisfy these expenses.*" R. 216, Ex. 24, p. 2 (emphasis in original). The Plan made no exception to full payment for the punitive damages portion of NL's claims. GHR's disclosure statement specifically described NL's claims, as provided for in the Plan, as including punitive damages. R. 216, Ex. 19, p. 373 (App. G).

The bankruptcy court's order confirming GHR's Plan expressly found that it provided for payment in full of all allowable administrative expenses under 11 U.S.C. § 507(a)(1), specifically including NL's claims being litigated in district court. R. 216, Ex. 18, p. 6-7. The bankruptcy court also expressly retained jurisdiction over determination of the allowance of claims. R. 216, Ex. 18 p. 13; Ex. 20, p. 187-189 (App. H, I). No one appealed confirmation of GHR's Plan.

On October 13, 1989, more than two years after confirmation, GHR moved for partial summary judgment on NL's district court complaint, arguing, in part, that punitive damages are not allowable administrative expenses as a matter of law. Holditch also moved for summary judgment. Both GHR and Holditch argued that Holditch's status as an "arbiter" under the Agreement insulated them from any liability based on negligence. Holditch, however, had an extensive prior business relationship with GHR which had not been disclosed to NL before it entered into the Agreement designating Holditch as an arbiter. R. 216, Ex. 2, ¶ 8; Ex. 15, ¶ 11.

The district court granted summary judgment in favor of both GHR and Holditch. The Fifth Circuit affirmed as to Holditch and reversed in part as to GHR.

The Fifth Circuit's holding that punitive damages based on postpetition torts by a debtor in possession cannot be an administrative expense conflicts with two decisions of this Court as well as decisions of at least the First, Fourth and Ninth Circuits and presents an important issue of bankruptcy law regarding Chapter 11 of the Bankruptcy Code and 28 U.S.C. § 959(b). The Fifth Circuit's holding also deprives NL of property without due process of law. The issue of whether punitive damages can constitute administrative expenses affects only the *priority* of NL's claim. By dismissing the claim in its entirety, the Fifth Circuit precluded NL from access to any procedural mechanism provided by the Bankruptcy Code for assertion and classification of its claims in bankruptcy. By even addressing the question of the classification of NL's claim at all the Fifth Circuit usurped the bankruptcy court's jurisdiction, undermined the terms of a final unappealable confirmation order which should have been res judicata and violated the

Bankruptcy Code's procedural mechanism for appeals of bankruptcy court orders.

The Fifth Circuit also held that Holditch's status as an arbiter insulated GHR and Holditch from any liability for negligence despite a contrary and controlling decision by this Court.

REASONS FOR GRANTING THE WRIT

I. The Fifth Circuit's Holding That Punitive Damages Are Not Administrative Expenses Conflicts With Decisions Of This Court And With Decisions Of Other Federal Appellate Courts And Presents A Question Important To Administration Of The Bankruptcy Laws That Should Be Addressed By This Court.

This case is governed by the principles established in *Reading Co.* v. *Brown*, 391 U.S. 471 (1968), and *Boteler* v. *Ingels*, 308 U.S. 57 (1939). *Reading* v. *Brown* stands for the proposition that postpetition tort claims are recoverable in full as administrative expenses in a Chapter 11 proceeding. 391 U.S. at 483, 485. *Boteler* v. *Ingels* establishes that a bankrupt's estate is liable for monetary penalties imposed by state law for wrongful postpetition conduct. 308 U.S. at 60-61. These two cases compliment each other, and both their holdings and underlying policies are directly applicable here.

Reading v. *Brown* held that "damages resulting from the negligence of a receiver acting within the scope of his authority as receiver give rise to 'actual and necessary costs' of a Chapter XI arrangement" and therefore constitute administrative expenses entitled to first priority. 391 U.S. at 485. *See* 11 U.S.C. §§ 503(b), 507(a)(1). This holding extends to all postpetition torts committed by a debtor in possession. This Court declined to distinguish among different torts,

held that all postpetition tort claims "should be potentially payable *in full*" and repeated that "the rule of *full recovery* for torts is demonstrably sounder." 391 U.S. at 483 (emphasis added).

Two fundamental Bankruptcy Code policies underlie *Reading* v. *Brown*. The first is fairness. Existing creditors hope that by postponement of their claims, they will, through rehabilitation, eventually recover a larger portion than they would in an immediate liquidation. *Id.* at 478. Fairness requires that those injured by continued operation of the business should recover ahead of those for whose benefit the continued operation of the insolvent business is allowed. *Id.* at 482-83. This principle comports with the historical conception of fairness: tort claims arising during a reorganization period have long been given administrative expense priority. *Id.* at 483 n.10. This Court considered various alternatives to administrative expense treatment and concluded that "none of these [alternatives] has case support, and all seem to us unsatisfactory." *Id.* at 479.

Fairness considerations apply with even more force here than to the purely negligence-based claims in *Reading* v. *Brown*. Unlike *Reading* v. *Brown*, existing creditors not only received a hypothetical benefit from GHR's continued operation but an actual benefit from NL's involvement in the reorganization. By funding $15 million for the workovers of 10 GHR gas wells, NL increased the productivity of those wells, thus increasing GHR's cash flow to the benefit of GHR and its existing creditors. It would be fundamentally unfair to allow those existing creditors who benefitted from this transaction to recover ahead of NL which was injured by the same transaction. *See Hofer* v. *Lavender*, 679 S.W.2d 470, 474-75 (Tex. 1984) (punitive damages are necessary to

compensate a tort victim for otherwise unrecoverable losses such as attorney's fees and intangible litigation costs).

The second Bankruptcy Code policy underlying *Reading* v. *Brown* is to encourage prudent and responsible operations by a debtor in possession to protect both existing creditors and postpetition claimants. In *Reading* v. *Brown*, the receiver had failed to maintain insurance. This Court pointed out that making claims potentially payable in full would encourage a receiver or a debtor in possession to obtain insurance in adequate amounts for the protection of the estate, its creditors and potential tort victims. 391 U.S. at 483. This observation illustrates an economic fact: reducing a debtor in possession's potential financial responsibility reduces its *operational* level of responsibility as well; it will be encouraged to take greater — and perhaps ill-advised — risks because the costs of failure have been reduced while the rewards of success remain the same or even increase. The Fifth's Circuit's decision encourages irresponsible, even fraudulent, behavior by eliminating the most serious consequences of such behavior.

Boteler v. *Ingels* serves a related policy: that of enforcing the debtor's compliance with state laws. In *Boteler* v. *Ingels*, this Court held that a bankrupt's estate is liable for postpetition civil tax penalties imposed by state law. 308 U.S. at 61. *Boteler* v. *Ingels* recognizes that entities operating under protection of the bankruptcy laws are not "immune from State laws or valid measures for their enforcement." *Id.* at 60-61. 28 U.S.C. § 959(b) explicitly subjects debtors in possession to valid state laws.

The Fifth Circuit's decision that punitive damages are not recoverable as administrative expenses under 11 U.S.C.

§ 503(b) conflicts with the decisions of other circuits applying *Reading* v. *Brown* and *Boteler* v. *Ingels*. The sole rationale for the Fifth Circuit's holding precluding punitive damages was that "we can conceive of no way in which allowing punitive damages would benefit GHR's estate." 940 F.2d at 966. This "no benefit" argument has been specifically rejected by several circuits considering claims based on postpetition misconduct of the debtor in possession.

The Ninth Circuit, stating that it is "well established that damages for a post-petition tort become an administrative expense," applied *Reading* v. *Brown* to allow a libel claim that included punitive damages. *In re Dennis Ponte, Inc.*, 61 B.R. 296, 298 (Bankr. 9th Cir. 1986). The Ninth Circuit not only rejected the result reached by the Fifth Circuit, it also rejected the Fifth Circuit's reasoning by recognizing that benefit to the estate is not an issue in cases involving postpetition misconduct by a debtor in possession. The Ninth Circuit held that *Reading* v. *Brown* "covers a broad range of non-contractual claims *which are not attended by benefit to the estate." Id.* (emphasis added). *Accord In re E.A. Nord Co. Inc.*, 78 B.R. 289, 290-91 (Bankr. W.D. Wash. 1987) (rejecting the "no benefit" analysis and holding that monetary sanctions against a debtor in possession for frivolous claims litigation were administrative expenses).

In *In re Charlesbank Laundry, Inc.*, 755 F.2d 200, 201-02 (1st Cir. 1985), the First Circuit held that a civil fine imposed for violation of a temporary injunction was allowable as an administrative expense. Like the Ninth Circuit, the First Circuit specifically rejected the "no benefit" argument. Quoting *Reading* v. *Brown*, the First Circuit held that it is "'more natural and just' to allow those injured by operation of a business during arrangement to 'recover ahead of . . . those for whose benefit the business is carried

on.'" *Id.* at 202. *Charlesbank Laundry* also pointed out that deliberate acts of the debtor present an even more compelling case for priority than did the facts in *Reading* v. *Brown*. *Id.* at 203. *Accord Carter-Wallace, Inc.* v. *Davis-Edwards Pharmacal Corp.*, 443 F.2d 867, 874 (2d Cir. 1971) (Friendly J.) The same reasoning applies to the intentional torts alleged by NL against GHR.

The Fourth Circuit's application of *Boteler* v. *Ingels* is similar. In *United States Dept. of Interior* v. *Elliott*, 761 F.2d 168, 169 (4th Cir. 1985), the Fourth Circuit held that a monetary penalty based on postpetition environmental misconduct was allowable as an administrative expense of preserving the estate. Both *Elliott* and *Boteler* v. *Ingels* recognize that debtors in possession are not exempt from civil penalties based on postpetition misconduct. The allowance of penalties as administrative expenses serves important societal interests: in *Elliott*, effecting compliance with environmental laws, 761 F.2d at 172 n.6; in *Boteler* v. *Ingels*, enforcing state tax laws, 308 U.S. at 61; in *E.A. Nord*, deterring frivolous litigation, 78 B.R. 290-91; and here, enforcing state fraud laws. The genesis of the penalty is not an issue. As *Elliott* held, the bankruptcy estate is subject to "*all* postpetition penalty claims, regardless of their type and regardless of whether they are incurred by the trustee or by the debtor in possession." 761 F.2d at 171 (emphasis in original). *Boteler* v. *Ingels* and *Elliott* apply here, and the same result should have been reached.

The Fifth Circuit's decision also subverts important policies central to the administration of the Bankruptcy Code. In addition to the policies served by *Reading* v. *Brown, Boteler* v. *Ingels* and their progeny, a principal statutory objective of Chapter 11 is rehabilitation of insolvent businesses. As *Reading* v. *Brown* makes clear, the concept of benefitting or

preserving the estate includes "the larger objective ... of operating the debtor's business with a view of rehabilitating it." 391 U.S. at 475. *Accord Carter-Wallace*, 443 F.2d at 874. Viewed in this light, the potential allowability of punitive damages in cases arising from postpetition business transactions does benefit the estate. Rehabilitation is impossible to achieve unless suppliers, insurers, lenders and the like conduct business with the debtor in possession. Such transactions are essential to the continued operation of the estate which, in turn, benefits the estate and its creditors. To induce a party to deal with the debtor in possession, that party must be afforded the same rights and remedies available against an entity that is not undergoing reorganization. Any increased risk makes a party more reluctant to deal with the debtor in possession, at a minimum necessitates higher prices to compensate for the increased risk and, consequently, hampers the debtor in possession's ability to reorganize.

These considerations apply forcefully to the facts of this case. NL agreed to deal with a reorganizing debtor in possession and was damaged by intentional torts committed by the debtor in the course of that business transaction. If a party so treated is not allowed full recovery, third parties whose participation is essential to reorganization may be unwilling to deal with the debtor in possession.

The overriding importance of protecting parties in postpetition business transactions with debtors in possession is evidenced by the fact that the Bankruptcy Code, to the extent possible, assures full payment of allowable postpetition administrative expenses under 11 U.S.C. § 503(b). The Code exempts postpetition claims from the automatic stay (*compare* 11 U.S.C. § 362 *with* 28 U.S.C. § 959(a)), affords postpetition administrative expenses first priority (11

U.S.C. § 507(a)(1)), and mandates that a plan shall not be confirmed unless it provides for their full payment (11 U.S.C. § 1129 (a)(9)(A)), thus effectively exempting postpetition administrative expenses from discharge. 11 U.S.C. § 1141(d)(1)(A) (confirmation discharges debts "*except as otherwise provided . . . in the plan or in the order confirming the plan . . .*") (emphasis added). The Fifth Circuit's decision debilitates the policies served by these and other Code provisions by reducing the consequences to debtors of recklessness or fraud, while saddling everyone who does business with a reorganizing debtor with the risks of its unlawful behavior.

Another goal of the Bankruptcy Code is enforcing a debtor in possession's compliance with the law and its obligation of good faith. These obligations balance the operational freedom granted to debtors in possession under 11 U.S.C. § 1107 and protect the jurisdictional integrity of the bankruptcy courts. *Matter of Little Creek Development Co.*, 779 F.2d 1068, 1071-73 (5th Cir. 1986). The recoverability of punitive damages serves this goal by "creat[ing] a strong incentive for vigilance by those in a position 'to guard substantially against the evil to be prevented'." *Pacific Mut. Life Ins. Co.* v. *Haslip*, _____ U.S. _____, 111 S. Ct. 1032, 1041 (1991). By freeing debtors in possession from the threat of punitive damages the Fifth Circuit's ruling undermines this statutory goal, encourages irresponsible and illegal conduct and makes bankruptcy a sanctuary for fraud and other misconduct. Moreover, by undercutting valid state laws designed to deter reprehensible conduct, the Fifth Circuit's decision raises important federalism concerns. *Cf. Kelly* v. *Robinson*, 479 U.S. 36, 47-49 (1986).

Finally, full payment also prompts creditors to monitor the acts of the debtor in possession to insure appropriate

operation of the business and compliance with the law. *Elliott* emphasized the watchdog role of creditors, pointing out that they can neither shield their eyes nor benefit from unlawful conduct by the debtor in possession. 761 F.2d at 171-72.

If the statutory privilege of reorganization is to work to the benefit of creditors, debtors and the economy as a whole, the courts must guard against its use as a sanctuary for corruption. The Fifth Circuit's decision, however, would permit reorganizing entities to abuse the privileges they enjoy by wilfully or recklessly inducing innocent parties to enter fraudulent transactions. Skewing business judgment by removing or reducing risks threatens harm not only to individual interests but to the balanced operation of the Code.

II. By Dismissing NL's Punitive Damages Claim Solely On The Basis That It Is Not An Allowable Administrative Expense, And By Circumventing The Procedural Protections Of The Bankruptcy Code, The Fifth Circuit's Ruling Deprived NL Of Property Without Due Process Of Law.

Even if the Fifth Circuit were correct in holding that NL cannot recover punitive damages from GHR's estate *as an administrative expense* under 11 U.S.C. § 503(b)(1)(A), only the *priority* of NL's claim would be affected. The administrative expense issue simply concerns whether NL "should be subordinated to, should share equally with, or should collect ahead of those creditors for whose benefit the continued operation of the business . . . was allowed." *Reading* v. *Brown*, 391 U.S. at 478.

If NL's punitive damages claim is not an administrative expense, it nevertheless remains a compensable claim of some type. NL's punitive damages claim against GHR is a species of property protected by the due process clause of the

Fifth Amendment. *Logan* v. *Zimmerman Brush Co.*, 455 U.S. 422, 429 (1982). The bankruptcy laws are subject to the commands of the Fifth Amendment. *United States* v. *Security Indus. Bank*, 459 U.S. 70, 75 (1982); *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445, 451 (1937).

To comply with the dictates of due process, the Bankruptcy Code must provide procedures to achieve "a fair, reasonable, and equitable distribution of [the debtor's] assets," *Kuehner* v. *Irving Trust*, 299 U.S. at 452, and the claimant must have the opportunity to assert its claims so that it may share in that distribution. *City of New York* v. *New York, N.H. & H. R. Co.*, 344 U.S. 293, 296-97 (1953). A postpetition tort claim is "compensable out of the assets of the estate," and if it is not allowed as a first priority administrative expense, there still must be "some means of asserting [the] claim against the business whose operation resulted in the" injury. *Reading* v. *Brown*, 391 U.S. at 478 n.7, 479. Summary dismissal of NL's punitive damages claim deprived NL of any means to assert its claim in bankruptcy court and therefore deprived NL of property without due process.

This unconstitutional deprivation occurred because the Fifth Circuit completely circumvented the Bankruptcy Code's claim classification system, ignored the appellate scheme set up by the Bankruptcy Code and usurped the bankruptcy court's subject matter jurisdiction. By finding that NL's claim for punitive damages was not an "actual, necessary cost of preserving the estate," the Fifth Circuit necessarily determined that NL's claim was not "allowable" as an administrative expense under 11 U.S.C. § 503, which would be entitled to first priority under 11 U.S.C. § 507(a)(1). Neither the district court nor the Fifth Circuit had subject matter jurisdiction to determine the allowability

or priority of claims, nor was the propriety of the bankruptcy court's orders classifying NL's entire claim as an administrative expense properly before either court.

A blanket Order of Reference in the Southern District of Texas, issued pursuant to 28 U.S.C. § 157(a), automatically vested the bankruptcy court with exclusive original subject matter jurisdiction over the GHR bankruptcy. *See In re Engra, Inc.*, 86 B.R. 890, 896 (S.D. Tex. 1988). The allowance or disallowance of a claim such as NL's is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B), and jurisdiction over the adjudication of core proceedings rests in the first instance with the bankruptcy court pursuant to 28 U.S.C. § 157(b)(1).

After the GHR bankruptcy was referred by the district court, there were only two methods by which the district court or the Fifth Circuit could have reacquired jurisdiction. The first is by an appeal to the district court under 28 U.S.C. § 158 of a bankruptcy court order. No one filed a timely appeal of the bankruptcy court's order confirming GHR's Plan, which classified NL's claim as an administrative expense and held that NL's claim did not impact on the feasibility of GHR's Plan. The bankruptcy court's confirmation order therefore became final and unappealable, and neither the district court nor the Fifth Circuit had subject matter jurisdiction to interfere with it. *In re Souza*, 795 F.2d 855, 857 (9th Cir. 1986). The confirmation order is *res judicata* as to all issues that could have been raised under a confirmed plan, including the classification of NL's claim. *Republic Supply Co.* v. *Shoaf*, 815 F.2d 1046, 1047 (5th Cir. 1987). To allow usurpation of the bankruptcy courts' subject matter jurisdiction and alteration of claim priorities long after the time for appeal has passed completely eviscerates the Bankruptcy Code's claim classification system,

undermines the finality of confirmed bankruptcy reorganization plans and vitiates the statutory bankruptcy appellate scheme.

The only other route by which the district court and the Fifth Circuit could have acquired subject matter jurisdiction over the allowability or priority of NL's punitive damages claim as an administrative expense is under 28 U.S.C. § 157(d), which provides that "[t]he district court may withdraw, in whole or in part, any case or proceeding referred [to the bankruptcy court] under this section, on its own motion or on timely motion of any party, for cause shown." GHR never made a § 157(d) motion for withdrawal of reference, however, and the district court never withdrew the reference as to the allowability or priority of claims.

The only withdrawal of the reference was at the behest of NL and did not concern the allowability or priority of its claim. NL initially filed suit in district court under 28 U.S.C. § 959(a). GHR removed the case to bankruptcy court on the basis that adjudication of NL's claims was a core proceeding. R. 1076. The bankruptcy court disagreed. Pursuant to the bankruptcy court's recommendation, the district court reasserted jurisdiction over the suit. R. 806, 807. The district court's order, however, simply returned the suit to its original posture. Only the merits of NL's state law claims were pending in district court under 28 U.S.C. § 959(a). The bankruptcy court expressly retained subject matter jurisdiction over all core bankruptcy proceedings, including determination of the allowance and priority of claims. R. 216, Ex. 18 p. 13; Ex. 20, p. 187-89. (App. H, I).

No legitimate argument can be made that the district court impliedly withdrew the reference on its own motion. First, the district court did not rule on the allowability of

NL's punitive damages claim. Second, any attempted withdrawal by implication would have been ineffective because the district court did not show the required cause for such a withdrawal. *In re Hall, Bayoutree Assoc., Ltd.*, 939 F.2d 802, 805 (9th Cir. 1991). Thus, the district court, and by extension the Fifth Circuit, never acquired subject matter jurisdiction over the allowability or priority of NL's claims.

The "show cause" requirement under § 157(d) mandates that a withdrawal of reference from the bankruptcy court "must be based on a sound, *articulated* foundation." *Holland America Ins. Co.* v. *Succession of Roy*, 777 F.2d 992, 998 (5th Cir. 1985) (emphasis added). The construction of § 157(d) by other courts has shown that Congress designed the show cause requirement to protect a fundamental right of bankruptcy creditors to avail themselves of the unique expertise of the bankruptcy courts. That requirement is not to be treated as a mere formality by a district court. *In re Parklane/Atlanta Joint Venture*, 927 F.2d 532, 536 (11th Cir. 1991); *In re Pruitt*, 910 F.2d 1160, 1168 (3d Cir. 1990). The show cause requirement is substantive. The failure to show cause for withdrawal of the reference as required by § 157(d) precluded the district court and the Fifth Circuit from reacquiring the referred subject matter jurisdiction.

Since neither the district court nor the Fifth Circuit had subject matter jurisdiction, adjudication of the allowability of NL's punitive damages claim as an administrative expense by the Fifth Circuit is void *ab initio*. The result of this void ruling is to preclude NL of any means of asserting its punitive damages claim in GHR's reorganization proceeding thus depriving NL of its claim without due process.

III. The Fifth Circuit's Holding That GHR And Holditch Are Insulated From Any Liability For Negligence Because The Agreement Designated Holditch As An Arbiter Is In Direct Conflict With *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145 (1968), Because Holditch Had An Extensive Prior Business Relationship With GHR Which Was Not Disclosed To NL.

Separate from the bankruptcy issues, the Fifth Circuit held that, while NL could recover from GHR for fraud, NL could not recover from GHR or Holditch for negligence because the Agreement designated Holditch as an arbiter with regard to the fracture treatment designs involved in the gas well workovers at issue. The Fifth Circuit's ruling directly conflicts with *Commonwealth Coatings Corp.* v. *Continental Cas. Co.*, 393 U.S. 145, 147-48 (1968).

Holditch had an extensive prior business relationship with GHR which was not disclosed to NL when it entered into the Agreement with GHR. R. 216, Ex. 10, pp. 8-9, 72. At that time, NL believed that Holditch had been retained to review the fracture treatment designs by GHR's bank creditors or by the bankruptcy court. R. 216, Ex. 2, ¶ 8; Ex. 15, ¶ 11. NL had no knowledge that Holditch had previously done extensive work for GHR. *Id.* NL's evidence in this regard must be taken as true because this is a summary judgment proceeding. *Anderson* v. *Liberty Lobby*, 477 U.S. 242, 255 (1986).

This Court held that an arbiter's decision could not be binding under such circumstances:

> It is true that petitioner does not charge before us that the third arbitrator was actually guilty of fraud or bias in deciding this case, and we have no reason, *apart from the undisclosed business relationship*, to suspect him of

> any improper motives. But neither this arbitrator nor the prime contractor gave to petitioner even an intimation of the close financial relations that had existed between them for a period of years.

Commonwealth v. *Continental*, 393 U.S. at 147-48 (emphasis added). Agreeing to arbitration does not suspend the elementary requirements of impartiality taken for granted in every judicial proceeding. *Id.* at 145. *See State* v. *Buckner Const. Co.*, 704 S.W.2d 837, 842 (Tex. App. — Houston [14th Dist.] 1985, writ ref'd n.r.e.) (arbiter's decision may be set aside for implied bad faith or failure to exercise an honest judgment). Certiorari should be granted to review the Fifth Circuit's ruling because it conflicts with *Commonwealth* v. *Continental.*

CONCLUSION

In depriving Chapter 11 administrative expense claimants of full recovery for postpetition torts the Fifth Circuit has created a conflict not only with *Reading* v. *Brown* and *Boteler* v. *Ingels*, but with the decisions of other circuits applying those cases. The Fifth Circuit fashioned this sweeping revision of bankruptcy law in a misguided effort to benefit the estate. In doing so, it twisted the most fundamental and uniform goals of the Bankruptcy Code away from the sound policies of rehabilitating insolvents and encouraging responsible and lawful business practices, and toward the flawed result of offering sanctuary to the unscrupulous. The Fifth Circuit has sapped the force of valid state laws with which the Bankruptcy Code was never intended to interfere.

The Fifth Circuit's dismissal of NL's punitive damages claim also presents a fundamental denial of due process. The court's ruling that NL's claim is not a priority administrative expense does not justify dismissal, but only reclassification. Moreover, it deprives NL of any means to assert its claim in

bankruptcy court, and it was accomplished without subject matter jurisdiction. Finally, the Fifth Circuit's ruling dismissing NL's negligence claims on the basis that Holditch was an arbiter is in direct conflict with a prior ruling of this Court. NL requests that this Court grant a writ of certiorari to review these rulings of the Fifth Circuit or grant the petition, vacate and remand.

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